

HONORABLE RONALD B. LEIGHTON

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT TACOMA

UNITED STATES,

Plaintiff,

v.

TROY X. KELLEY,

Defendant.

CASE NO. CR15-5198 RBL

ORDER ON RULE 404(b) STATE
TAX EVIDENCE

THIS MATTER is before the Court on Defendant Kelley's Motion to exclude Rule 404(b) evidence regarding state taxes. [Dkt. #231].

The government seeks to introduce evidence of Kelley's state (B&O) tax treatment of the retained reconveyance fees, because it claims that treatment is inconsistent with his representations to Old Republic and to the IRS.

Kelley argues that admitting evidence of his state tax "behavior" with respect to the retained fees would be "serious error" under *United States v. Martin*, 796 F.3d 1101 (9th Cir. 2015). He claims that the government cannot show that the state tax treatment was improper, and even if it could, that "other act" is not admissible to show his *mens rea* as to the federal tax charges.

1 Rule 404(b) prohibits evidence of another crime or act to prove character in an effort to
 2 show that on a particular occasion, the defendant acted in accordance with that character. But it
 3 permits the introduction of other wrongs or acts for another purpose, such as motive, intent, or
 4 knowledge:

5 (1) **Prohibited Uses.** Evidence of a crime, wrong, or other act is not
 6 admissible to prove a person's character in order to show that on a particular
 occasion the person acted in accordance with the character.

7 (2) **Permitted Uses; Notice in a Criminal Case.** This evidence may be
 8 admissible for another purpose, such as proving motive, opportunity, intent,
 preparation, plan, knowledge, identity, absence of mistake, or lack of accident.[]

9 Fed. R. Ev. 404(b). Under *Martin* and prior authority, the Court applies a four part test for
 10 admitting this evidence under Rule 404(b): the government must show that “(1) the evidence
 11 tends to prove a material point; (2) the other act is not too remote in time; (3) the evidence is
 12 sufficient to support a finding that defendant committed the other act; and (4) (in certain cases)
 13 the act is similar to the offense charged.” *Citing United States v. Bailey*, 696 F.3d 794, 799 (9th
 14 Cir. 2012). “If the evidence meets this test under Rule 404(b), the court must then decide
 15 whether the probative value is substantially outweighed by the prejudicial impact under Rule
 16 403.” *Id.*

17 In *Martin*, the government introduced evidence that, in 1996 and 1997, the taxpayer had
 18 been audited for taking \$3000 in inappropriate state tax deductions (related to farm expenses), to
 19 prove that she had, in 2002 – 2008 committed the crime of “subscribing to false federal tax
 20 returns” (by failing to report income from the sale of construction materials, and thus avoiding
 21 \$100,000 in federal taxes). Indeed, the government expressly asked the jury to consider Martin's
 22 prior state “tax cheating” as evidence that she had committed the federal “tax cheating” for
 23 which she was on trial. *Martin*, 796 F.3d at 1104, 1108.

1 Martin's conviction was vacated. Not only did the evidence violate Rule 404(b)(1),
2 Martin's conduct was remote in time from the conduct charged, and was similar to that conduct
3 in only the broadest sense. The earlier state tax audit was not relevant or admissible to prove that
4 she knowingly violated federal tax law. *Martin*, 796 F.3d at 1106.

5 Here, the government seeks to introduce Kelley's state tax treatment of the fees to refute
6 his claims about when the fees were earned. It seeks to show that Kelley's explanations to Old
7 Republic and to the IRS about how he treated the fees were "knowingly false and opportunistic,"
8 by showing that his contemporaneous treatment of the fees for state tax purposes was
9 inconsistent with those explanations— whether the state tax treatment was proper or not.

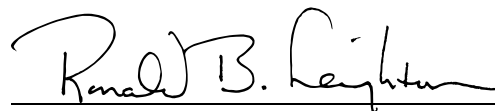
10 This alleged inconsistency tends to prove a material point, the conduct is not at all remote
11 in time—it concerns the same pool of money—and the evidence supports a finding that Kelley's
12 treatment was inconsistent with his explanations. The evidence is not offered to show that Kelley
13 mistreated the money for state purposes, and that he therefore must have treated it improperly for
14 federal purposes. This case, therefore, is materially different than *Martin*.

15 This evidence is admissible to show Kelley's intent with respect to his Old Republic and
16 IRS explanations, and his knowledge that those explanations were inconsistent with his conduct.

17 Kelley's Motion to Exclude the Rule 404(b) evidence of his state law tax treatment of the
18 fees is DENIED.

19 IT IS SO ORDERED.

20 Dated this 17th day of March, 2016.

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23 Ronald B. Leighton
24 United States District Judge